

The importance of scrap identification

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Introduction

ABC (Pvt) Ltd is a joint venture between the XYZ Group and the LPC group of Belgium. ABC (Pvt) Ltd mainly manufactures tires, rim and tracks. Issue arises from ABC (Pvt) Ltd for the financial year 2012/2013. The selected issue is relating to the rim, raw materials and the related stocks. Client used steel pallets with various gage for prepare rim. Following has been performed during the stock count and physical verification of the stock.

- Select highest value of stock which was cover at least 50% of the total stock
- Randomly select stocks physically in the floor and cross checked with the client given stock sheet (Floor to Sheet)
- Randomly select stock from stock sheet and cross checked that stocks physically located in stores/factory (Sheet to Floor)

Discussion of the Issue

There were steel that represent high value as well as in stock sheet represent high number of quantity. Actually there were no physically exist huge number of quantity as cross checked with the stock sheet.

There was an issue related to the updating stocks at the system. The identified procedure for preparing rim is as follows:

- For rim there was standard size.
- When preparing rim client cut the standard size from the steel and rest of the steel identified as scrap.



When purchase steel client pick to the system whole of the steel and actually client used $\frac{1}{4}$ of that and that $\frac{1}{4}$ transfer to the Cost of Sales. But client do not identify the scrap steel throughout the system and client do not transfer the scrap material from stock account.

Conclusions and Recommendations

Result of high value of closing stock influence for over estimate of gross profit and net profit of the company. Accordingly the company was non compliance with LKAS 02 - Inventory.

The company must adhere to the LKAS 02 – Inventory by identifying stock and scrap items separately. And when stock is issued and used for production client should update the system on time, by separately identifying scrap material and cost of sales. And there should be a proper internal control to identify scrap items and when selling for outsiders there should be proper valuation policy and proper authorization. The bulk scrap material should write off from the financial year and to interpret correct value of gross profit as well as the correct value of the net profit.